Patricia Lenkov – January 2015

The Corporate Governance Climate for 2015

In the ever-changing and always dynamic world of corporate governance it can be challenging to keep up with the trends and developments when not focused on these matters full-time. Post corporate implosions of the past 10 years and the subsequent regulatory changes and demands on continuous improvement and increased transparency in the boardroom have heightened the pace of change for boards everywhere. 2015 will surely continue this trend. Accordingly, here are some of the important issues from the world of corporate governance that should continue to make the news and be the subject of debate and speculation:

Gender Diversity

The topic of gender diversity in the boardroom (or lack thereof) has never been more focused on than at present. According to Catalyst, the U.S. based non-profit, women now hold 19.2% of all seats on S&P 500 boards. In Canada the number is slightly better at 20.8% of seats on the S&P/TSX60 index.

2015 will undoubtedly see more push to increase the number of women board directors. Quotas in countries as varied as Norway, Australia and The United Arab Emirates are having an impact as other countries debate and question their own policies. It is generally surmised that here in the US, gender quotas will not materialize. Most believe that there are other ways to “move the needle.” This includes term limits, age limits and other board refreshment approaches (more on this later.) Nevertheless we have definitely moved past the question of whether more women in the boardroom leads to improved results because it has been proven time and again that it does.

Other Types of Diversity

To maximize effectiveness, the composition of a corporate board should reflect its customers, the employees of the company and even other stakeholders such as investors. Consequently, diversity in the boardroom does not start and end with gender. In fact, it is safe to say that diversity in the boardroom, at least here in the US, has been a focus of attention for some time. However the context has historically been ethnic diversity.

Diversity in practice is far more complex than ethnicity and gender. In reality, diversity in terms of age, education, culture, income and even communication style and ability should be considered. Earlier this month, the State Treasurer of California, John Chiang called for a broadening of the term diversity to include sexual orientation and gender identity. The upshot of all of this is sharpened discussion, deliberation and ultimately decision making when members of the board are not clones of each other.

Activist Investors

According to McKinsey, shareholder activists launched an average of 240 campaigns a year for the past three years. Last year they launched 344 campaigns, according to The Economist. Moreover, their targets are increasing in size. Procter & Gamble and Dow Chemical are just two examples. Activists’ breadth of focus is also expanding. They look to influence not only the structure and financials of the company but also their board composition and even some of their operations.

Although it feels as if we cannot look at the business news without reading something about an activist campaign, it is a fact that most activism is undisclosed and goes on behind the scenes. In the typical scenario, activist and company have a dialogue and come to some compromise agreement that is mutually agreeable and mutually beneficial. Only when this does not happen do we then read about the discord.

Essentially, shareholder activism is here to stay and in terms of corporate governance, this means that directors are being held increasingly accountable. Companies need to be proactive and plan for the possibility of an activist overture. They must regularly communicate with their major shareholders and understand what is expected from them. Board directors also have a duty to be prepared and educated on whether and how to respond. They all need to be kept up-to-date on the trends and developments in shareholder activism. KPMG research has shown that 60% of companies state that they do not have an activist plan. Time to change this.

Cybersecurity

It can safely be said that every company today is a technology company. Even if your product is an automobile or other type of widget or even a retail store, your business is increasingly reliant on technology in ways that were perhaps inconceivable several years ago. There is really no end to the possibilities of how technology will continue to impact businesses. Consequently, the need to protect companies from threats that are novel and elusive is critical. Boards are grappling with these threats and challenges and will need to continue to plan for and prepare for what can feel like an inevitable breach. The implication here is that boards best secure strong technology expertise in one or more of their board members. A Chief Technology or Chief Information Officer is really a business leader and technology strategist. What board couldn't do with more of this aptitude?

Another way to look at this is that one of the board's main responsibilities is risk management. Cybersecurity is a mechanism of risk management and boards have a fiduciary responsibility to oversee this.

Board Refreshment

Board refreshment is a term that is being used ever more frequently. Quite simply, there is continued pressure for boards to update themselves more regularly than they have in the past. The idea is that routine turnover on boards is necessary to introduce new ideas, experiences and to keep up with the dynamic needs of the business. The focus, strategy and challenges of any company are constantly changing and the ability to respond at a strategic level with the appropriate set of skills and experiences must thereby evolve as well.

The counter argument is that boards and the companies they serve benefit from tenured and experienced board members who know the business and industry since they have been engaged it for some time. The best practice is somewhere in the middle. Boards, shareholders and the professionals that serve them will continue to deliberate on this matter in 2015.

Board Evaluation

Years ago, when I began recruiting board directors, the concept of board evaluation was an anomaly. For the most part, boards were made up of very experienced CEOs and by definition did not require, nor would they often subject themselves, to evaluation. These glory days are gone.

Effective and regular board evaluations adds insight and value. This year we will continue to see a great deal of development in this arena. To wit, the Council of Institutional Investors (CII) in 2014, released a report that suggested two approaches for boards to better disclose the process by which they evaluate themselves. This is important because evaluations are a way to reflect and deliberate on the functioning and effectiveness of the board. Several standardized tools have also recently been developed to make the process more efficient and less subjective.

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This list is not meant to be exhaustive. Rather is represents a cross-section of topics in the on-going evolution of corporate governance globally. Many of these issues are novel with little precedent and hence bringing them to the foreground will hopefully allow for preparedness and precaution.